The Pakistan Credit Rating Agency Limited

Rating Report

Mehran Sugar Mills Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Sep-2021	A-	A2	Stable	Maintain	-
30-Sep-2020	A-	A2	Stable	Maintain	-
22-Oct-2019	A-	A2	Stable	Maintain	-
03-May-2019	A-	A2	Stable	Maintain	-
03-Dec-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan's sugar industry is the country's 2nd largest agro-based industry, comprising 90 mills with an annual crushing capacity estimated ~65–70mln MT. The industry is trying to overcome the supply challenges. However, support price, set by considering the cost incurred by farmers, remains a constraint. During MY21, the overall sugar production increased by 15%, YoY, to 5.6mln MT (MY20: 4.9mln MT) due to better crop availability and an increase in area under cultivation. The recent surge in local sugar prices was registered by the demand-supply gap. Previously, the sales tax levied on sugar was increased to 17% (previously 8%,) charged on the PKR 60/KG price, which contributed to higher prices. In the FY21 budget, a sales tax of 17% was proposed to be levied on the market retail price instead of PKR 60/kg. However, Government has allowed not to charge sales tax on market retail price till Nov-21. Moreover, in MY21 crushing season, the Government increased the support price of sugarcane to PKR 200 per maund (previously, it was increased to PKR 190 from PKR 180 per maund). Actual realized sugarcane prices at the mill gate were even higher. To meet the local demand and curb the hike in sugar prices, the Government planned to import 0.8mln MT of sugar. Out of this, 0.3mln MT has already been imported, till Jun-21. Lately, TCP approved to import another 0.1mln MT of sugar.
The ratings reflect Mehran Sugar Mills Limited's ('Mehran Sugar' or 'the Company') strong business profile emanating from a diversified revenue stream, robust governance, and ability to post high recovery rates consistently, averaging in excess of 11% over the past five years. The Company was able to increase sugar production during MY21 despite the low availability of cane. Resultantly, the cane was procured at a higher rate. To mitigate risks associated with seasonality and volatility in the sugar industry, the Company's profitability is supported through a strategic joint venture investment in 'Unicol Limited', an ethanol production company, and sale of electricity generation. The Company has made strategic investments in the FMCG sector through a joint-venture 'UniFoods Industries Limited' and in the energy sector through its wholly-owned subsidiary, 'Mehran Energy Limited'. The Company benefited from the share of profit from Unicol Limited during the current year. The ratings draw comfort from Mehran Sugar's ability to maintain healthy topline and sizable short-term investment portfolio. The Company has mainly invested in the banking sector and other stable scrips to mitigate the investment risk. The Company's financial risk profile is characterized by a moderately leveraged capital structure, adequate coverage ratios and adequate working capital management.

The ratings are dependent on the Company's ability to maintain strong cashflows and coverages while adhering to strict financial discipline, with an increased emphasis on working capital management. Any significant deterioration in margins and/or coverages will adversely impact the ratings.

Disclosure

Name of Rated Entity	Mehran Sugar Mills Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Sugar(Dec-20)
Rating Analysts	Faiqa Qamar | faiqa.qamar@pacra.com | +92-42-35869504

Profile

Legal Structure Mehran Sugar Mills Limited ('Mehran Sugar' or 'the Company') is a public limited company incorporated in December, 1965. The Company is listed on PSX.

Background The Company commenced operations three years after incorporation in 1968 with a production capacity of 1,500 TCD (Tons of Cane per Day). Over the years, the Company managed to increase its crushing capacity to 12,500 TCD through capacity enhancement initiatives. Mehran Sugar entered in strategic partnership with other sugar companies in 2004 to establish a jointly operated distillery under the banner 'Unicol Limited' which has ethanol production capacity of 200,000 liters/day.

Operations The Company primarily maunufactures sugar and its allied products. The mill is located in District Tando Allahyar, having an installed capacity of 12,500 TCD. During 9MMY21, the Company crushed 682,253 MT of sugarcane to produce 73,092 MT of sugar while yielding a sucrose recovery rate of 10.71% (9MMY20: 11.13%).

Ownership

Ownership Structure Majority shareholding rests with individuals of Hasham Family (75%) ('Hasham Group'). Shareholding is divided among families of three brothers, Mr. M. Kasim Hasham (16%) and Mr. Khurram Kasim (11%), Mr. M. Ebrahim Hasham (14%) and Mr. Ahmed Ebrahim Hasham (11%), and Mr. M. Hussain Hasham (15%). The remaining shareholding belongs to general public and other corporations.

Stability The Company's controlling interests vests with one group and each family within the group holds a defined share. The ownership of the Company is seen as stable.

Business Acumen Mehran Group started its first business enterprise in 1930s with Mr. Haji Hasham trading in commodities. Mehran Sugar was incorporated in 1965 that continued as a single business enterprise. Hasham Group ('the Group') has undergone forward integration and entered the Ethanol segment through Unicol Limited. The Group has lately ventured into FMCG sector through a joint venture 'UniFoods Limited'. The group has also vested and Energy Sector (Mehran Energy Limited and UniEnergy Limited).

Financial Strength Majority of the Groups' stakes are consolidated through its Flagship Company Mehran Sugar. In MY20, the Company had a consolidated asset base of PKR 5.2bln which is financed through PKR 2.6bln in Equity and PKR 1.5bln in total debt.

Governance

Board Structure Board of Directors comprises of ten individuals, which include two executive directors, five non-executive directors and three independent Directors.

Members' Profile Sponsoring family has a strong presence on the Board. However, members have significant experience in the sugar industry which is balanced by an adequate mix of business, finance, and legal experts. Mr. Kasim Hasham, Chairman of the BoD, has significant experience in sugar and packaging industry. During the year, Independent Directors, Mr. Muhammad Bashir and Dr. Amjad Waheed resigned. Mr. Iftikhar Soomro and Mr. Hasan Aziz Bilgrami have been appointed to fill the casual vacancies in Apr-21.

Board Effectiveness In order to maintain effective oversight, Board of Directors have formed two committees, namely, the Audit Committee and the Human Resource and Remuneration Committee. During the MY20, four meetings of the Audit Committee and two meetings of the Human Resources and Remuneration Committee were conducted.

Financial Transparency M/s EY Ford Rodhes, classified in category 'A' by SBP, with a satisfactory QCR ratings. They have issued an unqualified opinion on Sep-20 financial statements.

Management

Organizational Structure The Company is headed by the Managing Director under the oversight of the Chief Executive Officer. The Company's Chief Financial Officer, Resident Director and Director Cane report directly to the Managing Director. HR & IT are headed by the separate managers and they report to CEO and CFO.

Management Team Management has long association with Mehran Sugar adding the required experience in sugar industry and their respective fields. Mr. Ahmed Ebrahim Hasham, son of the Chairman, Mr. Ebrahim Hasham, acts as the Managing Director of the Company.

Effectiveness The Company has instituted an Executive Committee comprising of the all head of departments headed by the CEO and MD. The Committee meets on a monthly basis for review performance and enable short-term decision making.

MIS Mehran Sugar has deployed an in-house system which has a sugar cane management module, store management module and human resources module. These are all integrated with the accounting system which is also developed in-house.

Control Environment The Board has outsourced the internal audit function to Grant Thornton Anjum Rahman.

Business Risk

Industry Dynamics Pakistan's sugar industry is the country's 2nd largest agro-based industry, comprising 90 mills with an annual crushing capacity estimated ~65–70mln MT. During MY21, the overall sugar production increased by 15%, YoY, to 5.6mln MT (MY20: 4.9mln MT) due to better crop availability and an increase in area under cultivation. The recent surge in local sugar prices was registered by the demand-supply gap. In the FY21 budget, a sales tax of 17% was proposed to be levied on the market retail price instead of PKR 60/kg. However, Government has allowed not to charge sales tax on market retail price till Nov-21. Moreover, in MY21 crushing season, the Government increased the support price of sugarcane to PKR 200 per maund (previously, it was increased to PKR 190 from PKR 180 per maund). Actual realized sugarcane prices at the mill gate were even higher. To meet the local demand and curb the hike in sugar prices, the Government planned to import 0.8mln MT of sugar. Out of this, 0.3mln MT has already been imported, till Jun-21. Lately, TCP approved to import another 0.1mln MT of sugar.

Relative Position The Company contributed approximately ~2% to the total sugar production in the country.

Revenues The Company generates most of its revenue from the sale of refined sugar (~90%). However, sale of molasses (7%) and bagasse (2%) also contribute to the Company's turnover. During 9MMY21, the Company's topline dipped slightly and stood at PKR 4.8bln (9MMY20: PKR 5.2bln) mainly due to lower volumetric sales.

Margins During 9MMY21, the Company posted an increased gross margin of ~13%, as compared to ~11% in the corresponding period due to higher selling price of sugar compared to the costs incurred by the Company. Similarly, operating margin stood at 9% (9MMY20: 6.6%). At net level, the Company benefited from other operating income of PKR 168mln and posted net income of PKR 263mln (9MMY20: PKR 78mln). Net profit margin increased to 5.4% (9MMY20: 1.5%).

Sustainability Strong demand coupled with high prices in the local market is expected to bode well for the company in future.

Financial Risk

Working Capital During 9MMY21, the Company was able to improve net working capital days on the back of lower inventory days due to offload of carry over stock during the period. Inventory days during 9MMY21 dropped to 48 days as compared to 62 days in 9MMY20. As a result of this, net working capital days stood at 45 days during 9MMY21 (9MMY20: 52 days). Short-term trade leverage improved significantly but still remains stretched.

Coverages Free cash flows stood at ~PKR 352mln in 9MMY21 (9MMY20: ~PKR 436mln). The Company finance cost stood at PKR 188mln in 9MMY21 (9MMY20: PKR 259mln). Interest cover improved to 1.9x during 9MMY21 (9MMY20: 1.7x). However, core and total interest cover stood at 0.7x each. (9MMY20: 1.6x each). Debt Payback period increased to 6.4x compared to 4.3x in 9MMY20.

Capitalization The Company has a moderately leveraged capital structure, represented by a debt-to-equity ratio of ~54% as of 9MMY21. Total debt is inclined towards short-term borrowings which represented 61% of total borrowings in 9MMY21. Short-term lines are utilized to support operations during the crushing cycle. During 9MMY21, total borrowings stood at ~PKR 3,347mln (9MMY20: PKR 2,623mln).

PKR mln

Mehran Sugar Mills Limited	Jun-21	Sep-20	Jun-20	Sep-19	Jun-19	Sep-18
Sugar	9M	12M	9M	12M	9M	12M
A BALANCE SHEET						
1 Non-Current Assets	2,192	2,273	2,289	2,192	2,159	2,169
2 Investments	1,428	1,108	865	995	1,065	1,259
3 Related Party Exposure	1,126	1,236	1,325	1,363	1,248	1,192
4 Current Assets	2,539	584	1,958	2,413	3,247	2,215
a Inventories	*1,655*	*61*	*1,278*	*1,061*	*2,164*	*1,167*
b Trade Receivables	*200*	*18*	*103*	*79*	*354*	*131*
5 Total Assets	7,285	5,201	6,437	6,963	7,719	6,834
6 Current Liabilities	679	687	922	1,334	1,112	858
a Trade Payables	*170*	*157*	*244*	*311*	*295*	*98*
7 Borrowings	3,347	1,579	2,623	2,833	3,619	2,955
8 Related Party Exposure	-	-	-	-	-	-
9 Non-Current Liabilities	396	327	384	382	451	412
10 Net Assets	2,862	2,608	2,509	2,415	2,538	2,609
11 Shareholders' Equity	2,862	2,608	2,509	2,415	2,538	2,609
B INCOME STATEMENT						
1 Sales	4,848	6,425	5,164	5,312	3,995	4,791
a Cost of Good Sold	*(4,206)*	*(5,960)*	*(4,613)*	*(4,491)*	*(3,192)*	*(4,201)*
2 Gross Profit	643	465	551	820	803	590
a Operating Expenses	(207)	(266)	(207)	(315)	(221)	(388)
3 Operating Profit	435	199	343	506	582	202
a Non Operating Income or (Expense)	*148*	*306*	*121*	*391*	*190*	*440*
4 Profit or (Loss) before Interest and Tax	583	505	464	897	772	642
a Total Finance Cost	*(190)*	*(342)*	*(262)*	*(385)*	*(290)*	*(212)*
b Taxation	*(130)*	*(116)*	*(124)*	*(108)*	*(112)*	*(17)*
6 Net Income Or (Loss)	263	47	78	404	369	413
C CASH FLOW STATEMENT						
a Free Cash Flows from Operations (FCFO)	*352*	*324*	*436*	*647*	*703*	*425*
b Net Cash from Operating Activities before Working Capital Changes	*348*	*156*	*100*	*338*	*646*	*454*
c Changes in Working Capital	*(1,940)*	*560*	*(539)*	*811*	*(783)*	*(877)*
1 Net Cash provided by Operating Activities	(1,592)	716	(439)	1,149	(138)	(422)
2 Net Cash (Used in) or Available From Investing Activities	(170)	1	131	(168)	(318)	(741)
3 Net Cash (Used in) or Available From Financing Activities	1,759	(1,380)	(306)	(324)	527	1,150
4 Net Cash generated or (Used) during the period	(4)	(663)	(614)	657	71	(13)
D RATIO ANALYSIS						
1 Performance						
a Sales Growth (for the period)	0.6%	21.0%	29.6%	10.9%	11.2%	-12.9%
b Gross Profit Margin	13.3%	7.2%	10.7%	15.4%	20.1%	12.3%
c Net Profit Margin	5.4%	0.7%	1.5%	7.6%	9.2%	8.6%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-32.7%	13.8%	-2.0%	27.4%	-2.0%	-9.4%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	14.3%	1.5%	4.0%	16.9%	20.6%	17.2%
2 Working Capital Management						
a Gross Working Capital (Average Days)	55	35	67	84	131	103
b Net Working Capital (Average Days)	45	21	52	70	117	95
c Current Ratio (Current Assets / Current Liabilities)	3.7	0.8	2.1	1.8	2.9	2.6
3 Coverages						
a EBITDA / Finance Cost	3.3	1.4	2.1	1.9	2.9	2.7
b FCFO / Finance Cost+CMLTB+Excess STB	0.7	0.7	1.6	0.9	1.4	1.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	6.4	-87.4	4.3	4.1	2.0	4.3
4 Capital Structure						
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	53.9%	37.7%	51.1%	54.0%	58.8%	53.1%
b Interest or Markup Payable (Days)	52.1	21.9	54.4	120.6	109.4	92.0
c Entity Average Borrowing Rate	8.4%	13.1%	11.5%	11.6%	9.9%	6.5%

Credit Rating

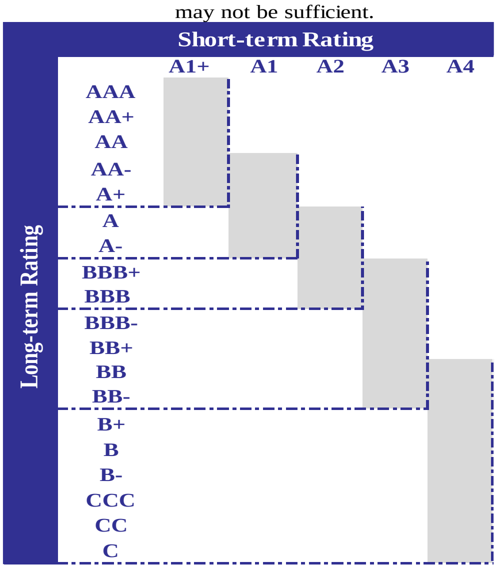
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities
a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
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iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

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(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
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(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

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(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
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(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
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(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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